

Message Text

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USOECD

USEEC ALSO FOR EMBASSY

USMTN ALSO FOR MISSION

PASS: TREASURY FOR SOLOMON AND WIDMAN; FEDERAL RESERVE
FOR GOVERNOR WALLICH

WHITE HOUSE FOR CEA CHAIRMAN SCHULTZE, WILLIAM NORDHAUS
AND SHAFER

E.O. 11652: GDS
TAGS: OECD, ECON
SUBJECT: ECONOMIC POLICY COMMITTEE: SUMMARY REPORT
ON MAY 29-30 MEETING OF COMMITTEE AND EXPANDED BUREAU

REF: (A) CPE(78)5, 6, 7, 8; (B) STATE 131364
(C) PARIS 16622 (D) PARIS 17241

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INTRODUCTION AND SUMMARY

1. EXPANDED EPC BUREAU (SUMMIT COUNTRIES) AGREED ON
OUTLINE OF BASIC ELEMENTS TO BE INCLUDED IN ECONOMIC
POLICY SECTION OF OECD MINISTERIAL COMMUNIQUE. THIS
APPROACH SUPPORTED IN GENERAL TERMS BY TENOR OF DISCUS-

SIONS IN EPC PLENARY AND WAS SUBSEQUENTLY ACCEPTED BY FULL EPC AT HEADS OF DELEGATION LUNCHEON ON SECOND DAY OF MEETING. OUTLINE TREATS CURRENT ECONOMIC SITUATION AND SKETCHES OUT ELEMENTS OF CONCERTED ACTION PROGRAM FOR SUSTAINED GROWTH. FOLLOWING UPON DISCUSSION OF GROWTH CONSTRAINTS AT FEBRUARY 27-28 EPC, OECD SECRETARIAT, AS STEP TOWARD JUNE 14-15 MINISTERIAL, HAD ELABORATED IN DOCUMENTATION FOR MAY 29-30 EPC A BROADER PROGRAM OF "CONCERTED ACTION" WHICH, IN ADDITION TO DEMAND MANAGEMENT POLICY, INCORPORATED TRADE, ENERGY, STRUCTURAL ADJUSTMENT AND MONETARY CONSIDERATIONS INTO A GENERAL STRATEGY FOR SUSTAINABLE GROWTH. SECRETARIAT ALSO SUGGESTED SPECIFIC NUMERICAL MAGNITUDES OF STIMULUS THAT EACH COUNTRY SHOULD UNDERTAKE. FOUR CATEGORIES OF COUNTRIES WERE INITIALLY PROPOSED (THOSE WHO COULD (A) "SIGNIFICANTLY" OR (B) "MODESTLY" EXPAND DOMESTIC DEMAND, THOSE WHO SHOULD (C) "PASSIVELY ACCEPT" GROWTH TRANSMITTED FROM (A) AND (B), AND THOSE WHO SHOULD (D) TAKE FURTHER STABILIZATION MEASURES). TWO CATEGORIES EMERGED AFTER DISCUSSION WHICH COMBINED (A) AND (B) INTO ONE, (C) AND (D) INTO OTHER. PRESENTATION OF ANY SPECIFIC NUMERICAL VALUES TO THE OECD MINISTERS WAS REJECTED.

2. EPC ALSO RECEIVED PROGRESS REPORTS FROM ITS WORKING PARTY TWO ON MEDIUM-TERM GROWTH PROSPECTS AND FROM THE CONFIDENTIAL

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AD HOC EXPERTS GROUP ON POSITIVE ADJUSTMENT POLICIES, WHICH ALSO MET MAY 29-30. THESE SUBJECTS REPORTED SEPTELS. NEXT EPC MEETING SET FOR THURSDAY-FRIDAY, NOVEMBER 16-17. EXPANDED BUREAU AGREED THAT INFORMAL CONSULTATIONS BETWEEN EPC BUREAU (CHAIRMAN SCHULTZE AND VICE CHAIRMAN WASS) AND SMALL GROUP (3-4 EACH) FROM TUAC AND BIAC COULD BE HELD IMMEDIATELY PRIOR TO NEXT MEETING (SEE STATE 131364).

A CONCERTED ACTION PROGRAM

3. THE ELEMENTS OF A CONCERTED ACTION PROGRAM AS OUTLINED BY CHAIRMAN SCHULTZE ORALLY TO EPC HEADS OF DELEGATIONS LUNCH ARE ROUGHLY AS INDICATED IN PARAGRAPHS 4 AND 5 BELOW. HOWEVER, THIS RENDITION IS ONLY INDICATIVE, SINCE THE CHAIRMAN WILL SEND IN APPROVED TEXT FROM WASHINGTON FOR CIRCULATION TO MEMBERS OF EPC.

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4. BACKGROUND OF ECONOMIC SITUATION:

(A) THE ECONOMIC AND SOCIAL CONSEQUENCES OF CURRENT
ECONOMIC PROSPECTS UNDER EXISTING POLICIES ARE UNACCEPT-
ABLE AND LIKELY TO PUT FURTHER DOWNWARD PRESSURE ON
ECONOMIC ACTIVITY:

-- GROWTH AND SHORT-TERM OUTLOOK ARE UNSATISFACTORY:
NORTH AMERICA IS CONSTRAINED BY INFLATION; EUROPEAN
GROWTH IS SLOW WITH NO OBVIOUS IMPROVEMENT FROM
1977; JAPAN HAS PRAISEWORTHILY AMBITIOUS TARGET.

-- UNEMPLOYMENT WILL NOT FALL OUTSIDE U.S.

-- INFLATION STILL TOO HIGH AND TOO GREATLY DIFFEREN-
TIATED.

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-- AREA-WIDE BOP DEFICIT SLIGHTLY REDUCED, BUT NO SIGNS

OF SUBSTANTIAL IMPROVEMENT ON DISTRIBUTION AMONG
MEMBER COUNTRIES.

-- DANGER OF DISORDER IN EXCHANGE MARKETS WILL CONTINUE
UNLESS ECONOMIC PERFORMANCE IMPROVES.

(B) IN MANY COUNTRIES, SCOPE NOW EXISTS FOR MODERATE
BUT DIFFERENTIATED INCREASES IN GROWTH WITHOUT SACRI-
FICING IN ANY SIGNIFICANT WAY INTERNAL STABILIZATION
OBJECTIVES.

(C) IF ACTIONS ARE UNDERTAKEN IN A NUMBER OF AREAS ON
A CONCERTED BASIS BY ALL OF OUR COUNTRIES, THE EXTERNAL
CONSTRAINTS WHICH MANY FACE WOULD BE RELAXED.

(D) SUCH CONCERTED POLICIES SHOULD PUT THE COUNTRIES OF
THE OECD ON A PATH TOWARDS THE KIND OF MEDIUM-TERM GROWTH
SET FORTH IN THE OECD MEDIUM-TERM GROWTH STRATEGY.

(E) GROWTH SHOULD BE ACHIEVED BY A COMBINATION OF ACTIONS
TO STIMULATE INTERNAL DEMAND AND POLICIES WHICH IMPROVE
THE ENVIRONMENT AND CONDITIONS FOR LONG-TERM SUSTAIN-
ABLE GROWTH. IN MANY COUNTRIES, THIS INVOLVES ESPECIALLY
IMPROVING THE PROSPECTS FOR PROFITS AND BUSINESS INVEST-
MENT.

5. ELEMENTS OF CONCERTED ACTION:

(A) WITH RESPECT TO ECONOMIC STIMULUS AIMED AT HIGHER
GROWTH, COUNTRIES HAVE VARYING SCOPE FOR ACTION DURING
THE NEXT 18 MONTHS:
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-- THERE IS ONE GROUP OF COUNTRIES (BELGIUM, CANADA,
FRANCE, GERMANY, ITALY, JAPAN, NETHERLANDS, SWITZER-
LAND, UNITED KINGDOM) WHOSE INTERNAL AND EXTERNAL
SITUATION IS SUCH THAT IN THE CONTEXT OF CONCERTED
ACTION THEY SHOULD UNDERTAKE TO ENSURE, BY APPROPRI-
ATE MEASURES AS NECESSARY, THE EXPANSION OF INTERNAL
DEMAND OVER THE NEXT 18 MONTHS AT A RATE GREATER THAN
THAT WHICH OCCURRED IN 1977. WITHIN THIS GROUP OF
COUNTRIES, BOTH THE NEED AND THE SCOPE FOR THE
EXPANSION OF INTERNAL DEMAND VARIES FROM COUNTRY
TO COUNTRY. (NOTE: SPECIAL LANGUAGE DESCRIBING
THE ROLE OF THE NETHERLANDS MAY BE NECESSARY GIVEN
THE HIGH GROWTH RATE OF DOMESTIC DEMAND IN THAT
COUNTRY IN 1977.)

-- MOST OTHER COUNTRIES WITHIN THE OECD WHO ARE NOT

CURRENTLY IN A POSITION TO TAKE EXPLICIT ACTION TO EXPAND INTERNAL DEMAND BEYOND WHAT IS NOW IN PROSPECT, CAN ACCEPT THE HIGHER GROWTH WHICH CONCERTED ACTION MAKES POSSIBLE THROUGH AN EXPANSION OF WORLD MARKETS. IN A FEW COUNTRIES, THE SITUATION WITH RESPECT TO INFLATION AND BALANCE OF PAYMENTS CONDITIONS ARE SUCH THAT THESE COUNTRIES SHOULD USE THE EXPANSION OF EXTERNAL DEMAND TO STRENGTHEN THEIR OWN STABILIZATION POLICIES WITHOUT ALLOWING THE OVERALL GROWTH OF DEMAND TO BE INCREASED.

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(B) WITH RESPECT TO ENERGY, IT IS IMPORTANT THAT ALL COUNTRIES HAVE IN PLACE ENERGY CONSERVATION AND SUPPLY-RAISING PROGRAMS. IT IS PARTICULARLY IMPORTANT FOR THE UNITED STATES TO PUT SUCH POLICIES QUICKLY IN PLACE IN VIEW OF THE IMPORTANCE OF SUCH ACTIONS FOR ITS CURRENT ACCOUNT DEFICIT AND FOR THE PROMOTION OF STABILITY IN INTERNATIONAL EXCHANGE MARKETS.

(C) IN ORDER TO ENSURE THAT ECONOMIC GROWTH IS CHAN-

NELED IN DIRECTIONS THAT ARE SUSTAINABLE IN THE LONG
RUN, ALL COUNTRIES SHOULD:

(1) JOIN IN SEEKING A PRODUCTIVE OUTCOME OF THE MTN
NEGOTIATIONS.

(2) AVOID PROTECTIONIST MEASURES AND WORK TOWARD A
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REDUCTION OF NON-TARIFF BARRIERS TO TRADE, AND,

(3) PROMOTE STRUCTURAL ADJUSTMENT BETWEEN DOMESTIC
INDUSTRIES AND SECTORS IN WAYS WHICH EMPHASIZE THE
MOBILITY OF CAPITAL AND LABOR, WHILE AVOIDING
DOMESTIC MEASURES WHICH TEND TO RIGIDIFY THE EXIST-
ING PATTERNS OF EMPLOYMENT AND OUTPUT AND SO PLACE
OBSTACLES IN THE WAY OF NEEDED ADJUSTMENT.

(D) CONCERTED POLICIES ALONG THE LINES DESCRIBED ABOVE,
IN ADDITION TO IMPROVING THE PROSPECTS FOR ECONOMIC
GROWTH, EMPLOYMENT, INVESTMENT AND PRODUCTIVITY IN ALL
OF OUR COUNTRIES, SHOULD ALSO HELP TO BRING ABOUT A
BETTER ALIGNMENT OF PAYMENTS BALANCES AND THEREBY CON-
TRIBUTE TO GREATER STABILITY IN INTERNATIONAL
EXCHANGE MARKETS. IN TURN, SUCH GREATER STABILITY WILL
IMPROVE CONFIDENCE AND IMPROVE THE ENVIRONMENT FOR SUS-
TAINED ECONOMIC GROWTH. COOPERATION AMONG MONETARY
AUTHORITIES OF OUR VARIOUS COUNTRIES IN INTEREST OF
FACILITATING ORDERLY CONDITIONS IN EXCHANGE MARKETS
WOULD STRENGTHEN THIS RESULT.

6. EPC PLENARY DISCUSSION OF CONCERTED ACTION: THE
BROADER APPROACH TO A GROWTH STRATEGY (ALONG LINES OF
PARAGRAPHS 4-5 ABOVE) GAINED WIDESPREAD SUPPORT WITH NO
DISSENTING OPINIONS ON THE NEED FOR FASTER SUSTAINED
GROWTH IN THE AREA. GERMANY, JAPAN AND AUSTRALIA PAR-
TICULARLY WELCOMED THE MENTION OF PROBLEM AREAS AND
POLICY NEEDS OTHER THAN DEMAND MANAGEMENT, WITH EACH
PUTTING SPECIAL EMPHASIS ON STRUCTURAL AND MEDIUM-TERM
QUESTIONS. WHILE ADMITTING THE NEED FOR SUPPLEMENTARY
POLICIES, NUMEROUS DELEGATIONS (INCLUDING PARTICULARLY
THE LESS-INDUSTRIALIZED OECD MEMBERS) EMPHASIZED THE
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DANGERS OF ALLOWING SLOW GROWTH TO CONTINUE, PARTICULAR-
LY THE THREAT TO THE MULTILATERAL FREE TRADING SYSTEM

AND THE SOCIAL PROBLEMS CAUSED BY EXPORT OF UNEMPLOYMENT FROM NORTHERN EUROPE. DISCUSSION WAS PERHAPS BEST SUMMARIZED BY FRENCH DEL (CORTESSE) WHO NOTED GENERAL AGREEMENT ON NEED FOR A CONCERTED ACTION PACKAGE, BUT GENERAL DISAGREEMENT ON HOW TO APPLY PACKAGE TO SPECIFIC CASES, PARTICULARLY FOR THOSE ASSIGNED AN ACTIVE ROLE. UK DEL (WASS) URGED THAT EPC GO BEYOND AGREEMENT ON PRINCIPLES AND BEGIN TO GIVE THOUGHT TO "STAGE MANAGEMENT" OF IMPLEMENTATION PHASE OF CONCERTED ACTION, WHICH WOULD REQUIRE KNOWLEDGE BY EACH COUNTRY OF WHAT OTHERS WOULD DO AND WHEN. SAME THOUGHT EXPRESSED IN TERMS OF A "CONCERT OF NATIONAL ACTION" BY NETHERLANDS DEL (POSTHUMUS). ALTHOUGH SOME ECONOMIC CONSTRAINTS EXIST, PRINCIPAL ROADBLOCKS TO TAKING APPROPRIATE POLICY MEASURES SEEM TO BE POLITICAL ABILITY TO TAKE ACTION AND DOUBTS ABOUT EFFICACY OF POLICIES. CLASSIC POLITICAL CONFLICTS AMONG SPECIAL INTERESTS OF DOMESTIC GROUPS, ON INCOME DISTRIBUTION AND ON THE ROLE OF THE PUBLIC SECTOR SEEM TO BE AT THE HEART OF CURRENT POLICY DEBATES. AGREEMENT, ALTHOUGH LESS THAN UNANIMOUS, EMERGED ON URGENT NEED TO GET POLITICAL CONSENSUS, AFTER WHICH ALREADY-IDENTIFIED ECONOMIC POLICY MEASURES COULD BE ENACTED.

7. COUNTRY AND POLICY ROLES IN CONCERTED ACTION PROGRAM:
EPC DISCUSSION OF SPECIFIC POLICY MEASURES RECOMMENDED BY THE SECRETARIAT GENERALLY EVOLVED INTO A DEBATE ON

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THE USEFULNESS OF DEMAND MANAGEMENT AS A STIMULUS IN THE PRESENT SITUATION, WHEN, AS SOME ARGUED, THE UNDERLYING CONDITIONS IN THE PRIVATE SECTOR SEEM INCOMPATIBLE WITH SUSTAINED RECOVERY. FOR EXAMPLE, GERMANY CITED MALAISE AMONG INVESTORS DUE TO COST STRUCTURES AND LOW PROFITS; SWITZERLAND CITED THE NEED FOR EXCHANGE RATE STABILITY (E.G., DEL EXPRESSED DESIRE TO "MAINTAIN THE MARCH/APRIL RATE FOR THE REST OF THE YEAR"); FRANCE CITED THE NEED FOR FURTHER REDUCTION IN INFLATION; NETHERLANDS, LOWER LABOR COSTS TO RESTORE COMPETITIVENESS. JAPAN REITERATED ITS COMMITMENT TO 7 PERCENT GROWTH FOR JFY79, BUT FELT NO NEW MEASURES WERE NECESSARY SINCE PRIVATE SECTOR SHOWED SIGNS OF RECOVERY. GERMANY CONTENDED THAT CURRENT UNDERLYING TRENDS WERE YET UNCLEAR, BUT IF 2.5 - 2.8 GROWTH FORECAST IS SHOWN RIGHT, THEN "SOMETHING WOULD HAVE TO BE DONE." MOST DELEGATES WERE FEARFUL OF THIS WAIT-AND-SEE ATTITUDE. UK DEL QUESTIONED WHO SOME COUNTRIES SO
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READILY ACCEPTED ARGUMENT THAT DEMAND MANAGEMENT POLICIES WOULD NOT WORK WHEN THERE WAS VIRTUALLY NO EMPIRICAL EVIDENCE TO SUPPORT THE HYPOTHESIS, WHILE THERE WAS ABUNDANT EVIDENCE FROM THE 60'S THAT THEY DID WORK. AT OPPOSITE END OF SPECTRUM WAS AUSTRALIAN DEL (STONE) WHO SAID CHARACTERIZATION OF CURRENT UNEMPLOYMENT RATES AS "UNACCEPTABLE" WAS TANTAMOUNT TO DESCRIBING "RAIN" AS "UNACCEPTABLE," SINCE EMPLOYMENT LEVELS COULD NOT BE POLICY OBJECTIVE, BUT RATHER WERE RESULT OF OTHER RELATIONSHIPS IN ECONOMIC SYSTEM. WITH REGARD TO DEMAND STIMULUS PROPOSALS IN SECRETARIAT'S SIMULATION, MOST COUNTRIES PREFERRED TO VIEW SIMULATION EXERCISE AS USEFUL WAY TO ILLUSTRATE SIZE OF POLICY ACTION NEEDED TO ACHIEVE DESIRED RESULTS, BUT DID NOT FEEL IT APPROPRIATE AT THIS TIME TO ENDORSE ANY SPECIFIC SET OF NUMBERS. GENERAL ORIENTATION TOWARD TAX CUTS RATHER THAN EXPENDITURE INCREASES (EXCEPT IN JAPAN) WAS WELCOMED.

8. INFLATION AND CONCERTED ACTION: OECD SECRETARIAT SUGGESTED IN EPC DOCUMENTATION THAT CONCERTED ACTION PROGRAM NECESSARY TO RAISE FORECAST 79I OUTLOOK FROM 3-1/2 PERCENT GROWTH TO 4-1/2 PERCENT WOULD ADD ABOUT 1/2 POINT TO INFLATION RATE FOR AREA AS A WHOLE. EPC WAS DIVIDED ON THIS SUBJECT, WITH SEVERAL (E.G., FRG, JAPAN, NETHERLANDS) EXPRESSING OPINION THAT RISK UNDER-

STATED; OTHERS ARGUED THAT THERE IS ALSO INFLATION RISK IN CONTINUED SLOW GROWTH IN VIEW OF PROTECTIONIST MEASURES, STRUCTURAL RIGIDITIES AND TENSION OVER INCOME SHARES. UK DEL NOTED DANGER OF TOO MUCH EMPHASIS ON EITHER INFLATION OR EMPLOYMENT, BOTH EXTREMES BEING SELF-DEFEATING; HE CONCLUDED THAT SITUATION NOW PERMITTED SOME GREATER STIMULUS WITHOUT REIGNITING INFLATIONARY SPIRAL. THOSE MOST FEARING INFLATIONARY IMPACT EACH
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CITED A DIFFERENT REASON: JAPAN NOTED RISK OF SHARP RISE IN COMMODITY PRICES ESPECIALLY OIL (WHILE NORWAY FELT SOME RISE IN COMMODITY PRICES NEEDED TO STIMULATE INVESTMENT IN KEY INDUSTRIES); GERMANY FEARED HIGHER WAGE DEMANDS FROM LABOR IN STRONGER GROWTH SITUATION; NETHERLANDS CITED BOTTLENECKS (ESPECIALLY IN CONSTRUCTION) WHOSE PRICE INCREASES WOULD SPREAD THROUGHOUT ECONOMY. ALL AGREED CURRENT AREA-WIDE INFLATION RATE TOO HIGH AND THAT FLANKING POLICIES WOULD LIKELY BE NEEDED TO HOLD DOWN PRICE RISE WHILE NOT STIFLING GROWTH.

9. INVESTMENT AND RECOVERY: SECRETARIAT ADVANCED ARGUMENT THAT PRIVATE INVESTMENT WAS KEY TO SUSTAINABLE RECOVERY AND MAINTENANCE OF POTENTIAL OUTPUT LEVELS, BUT THAT INVESTMENT WOULD NOT BE REALIZED UNLESS PROFIT RATES WERE RESTORED. DOCUMENTATION ADDED THAT CONSENSUS-TYPE INCOMES POLICY WAS NEEDED TO INSURE RESTORATION OF PROFITS. ALL DELS WHO ADDRESSED QUESTION AGREED THAT INVESTMENT ESSENTIAL AND THAT PROFIT SHARE CURRENTLY INSUFFICIENT. EPC DEBATE CENTERED ON WHETHER LOW PROFIT SITUATION COULD BE CURED BY INCREASED DEMAND (THUS HIGHER CAPACITY UTILIZATION RATES) OR WHETHER MORE FUNDAMENTAL CHANGES IN COST STRUCTURE WAS A PRIORI CONDITION TO REVIVAL OF INVESTOR CONFIDENCE. DEBATE NOT RESOLVED. IT WAS AGREED, HOWEVER, THAT REDUCTION IN INFLATION RATE CRUCIAL FACTOR IN ATTEMPT TO SPARK INVESTMENT RECOVERY. SEVERAL DELS (FRG, SWITZERLAND, AUSTRALIA) FLATLY REJECTED ARIPARTITE INCOMES POLICY AS SOLUTION TO FACTOR SHARE PROBLEM.

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COUNTRY NOTES (IN ORDER OF SPEAKING)

10. JAPAN: JAPANESE REPS (MIYAZAKI OF EPA, MATSUKAWA OF FINANCE MINISTRY) WELCOMED SECRETARIAT'S BROADENED APPROACH TO CONCERTED ACTION WITH INCREASED ATTENTION TO STRUCTURAL AND MEDIUM-TERM QUESTIONS, AND CALLED FOR PERIODIC REPORTS BY COUNTRIES ON EFFORTS THEY HAVE TAKEN TO "CARRY OUT THEIR RESPONSIBILITY." MARKET FORCES, ACCORDING TO MIYAZAKI, SHOULD BE GIVEN WIDEST POSSIBLE LATITUDE SINCE GOVERNMENT INTERVENTIONS AND PROTECTIONIST MEASURES ARE INHERENTLY HARMFUL TO EFFICIENT FUNCTIONING OF THE SYSTEM. JAPAN'S 7 PERCENT GROWTH TARGET DESCRIBED AS "APPROPRIATELY HIGH" FOR A WELL-PLACED COUNTRY AND RECENT SIGNS -- ESPECIALLY IN INDUSTRIAL PRODUCTION AND CONSTRUCTION -- WERE CITED TO SHOW THAT STIMULATIVE MEASURES RECENTLY TAKEN ARE WORKING. BUSINESS CONFIDENCE, CONFIDENTIAL

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AND THUS PRIVATE INVESTMENT, SHOULD BEGIN TO REVIVE AS PROFITS RATES ARE RESTORED DUE TO DECLINING RAW MATERIALS COST (I.E., YEN APPRECIATION), MODERATE WAGE SETTLEMENTS AND STRONG GOVERNMENT AND CONSUMER DEMAND. PRIVATE SECTOR STRENGTH MAKES JAPANESE AUTHORITIES FEEL NO FURTHER GOVERNMENT MEASURES NEEDED, BUT SUCH MEASURES WOULD BE TAKEN IF PROVED NECESSARY TO MEET 7 PERCENT JFY 1979 TARGET. SECRETARIAT, AS NOTED REF. C, DISAGREES AND FORECASTS ONLY 5.5 PERCENT FOR CY78 WITH FALL-OFF TO 4.5 IN

79I. ON CURRENT ACCOUNT, JAPANESE WOULD NOT GIVE 1978 PROJECTION DESPITE SOME PRESSURE FROM QUESTIONING AND WIDE APPARENT DIVERGENCE WITH SECRETARIAT (PROJECTING \$17 BILLION SURPLUS FOR 1978 VS. 11.5 BILLION BY GOJ GIVEN AT SHORT-TERM FORECASTERS). MATSUKAWA INSISTED THAT 1978 FIRST QUARTER SURPLUS WAS DUE TO SPECIAL FACTORS (AS NOTED AT SHORT-TERM FORECASTERS, I.E., J-CURVE, ANTICIPATION OF JAPANESE EXPORT CONTROLS AND EXPECTED U.S. WEST COAST DOCK STRIKE). HE AGREED WITH U.S. DEL (WALLICH) THAT STRONGER INTERNAL DEMAND WOULD REDUCE PRESSURE TO EXPORT, BUT ADDED THAT GLOBAL INFLATION TRENDS COULD OVERWHELM RESTRAINTS ON EXPORT VOLUME. ON EXCHANGE MARKETS, MATSUKAWA SAID TWO LESSONS HAD BEEN LEARNED IN RECENT MONTHS SO THAT JAPANESE ARE NOW MORE REALISTIC AND CONFIDENT ABOUT ADJUSTMENT VIA EXCHANGE RATE CHANGES, NAMELY (1) QUICK RESULTS SEEM NOT TO BE ACHIEVABLE SINCE FULL EFFECT REQUIRES 18 MONTHS OR SO (PARTIALLY NEGATED BY (A) FAILURE TO SLOW INFLATION IN DEPRECIATING COUNTRIES AND (B) DAMAGES TO CONFIDENCE OF FAST RATE CHANGES; AND (2) FEARS OF SERIOUS BLOW TO APPRECIATING COUNTRIES HAVE BEEN NEGATED.

11. GERMANY: FRG DEL (TIETMEYER OF ECONOMIC MINISTRY)

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"VIGTROUSLY SUPPORTED" THE BROADENED STRATEGY OF CONCERTED ACTION, EXPRESSING OPINION THAT STRUCTURAL PROBLEMS ARE MOST IMPORTANT ELEMENT IN A GROWTH STRATEGY WHEREAS "KEYNESIAN" ELEMENT OF "LIMITED VALUE." FOR 1978, HE RECITED NOW FAMILIAR LITURGY ABOUT CONFLICTING SIGNALS FROM FIRST QUARTER 1978 -- INSISTING THAT UNDERLYING TRENDS NOT CLEAR. IN POSSIBLY SIGNIFICANT DEPARTURE FROM PAST, HE THEN ADDED THAT "IF SECRETARIAT IS RIGHT AND (GROWTH) TRENDS ARE IN 2.5 - 2.8 PERCENT RANGE" THEN FRG "COULD NOT SIT BACK" AND WOULD HAVE TO DO SOMETHING. TIETMEYER SAID INVESTMENT WAS THE KEY IN FRG AND, WITHOUT ENTIRELY DENYING POSSIBLE INFLUENCE OF CAPACITY UTILIZATION RATES AND DEMAND PROSPECTS, ARGUED THAT IMPROVEMENT IN WAGE/COST STRUCTURE WAS PREREQUISITE TO IMPROVED INVESTMENT CLIMATE. RECENT DEVELOPMENTS IN CAPITAL MARKETS ALSO WORRISOME IN TERMS OF INVESTMENT COSTS SINCE INTEREST RATES SEEMED TO BE RISING, PERHAPS DUE TO HEAVY BURDEN OF PUBLIC FINANCING. UNEMPLOYMENT PROBLEM, ACCORDING TO TIETMEYER, ALSO DUE TO INAPPROPRIATE STRUCTURE OF LABOR MARKET CAUSED BY WAGE DISTORTIONS AT LOW END OF SCALE.

12. U.S.: SCHULTZE (CHAIRMAN, CEA) STATED THAT PERCEPTIONS ON THE U.S. SITUATION HAD CHANGED IN RECENT MONTHS.

A VERY SLGHT DECLINE IN REAL GNP IN THE FIRST QUARTER
1978 WILL PROBABLY BE FOLLOWED BY STRONG COMEBACK IN
SECOND QUARTER, SO THAT U.S. SHOULD BE ON TRACK EARLIER

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ICAE-00 INRE-00 /128 W

-----076090 051553Z /45

O R 051405Z JUN 78
FM AMEMBASSY PARIS
TO SECSTATE WASHDC IMMEDIATE 2599
INFO WHITE HOUSE
ALL OECD CAPITALS
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C O N F I D E N T I A L SECTION 06 OF 07 PARIS 17725

FORECAST BY 78II, MEANING 4 TO 4-1/2 PERCENT GROWTH GNP
DECEMBER 1978/DECEMBER 1977. UNEMPLOYMENT RATE IS MUCH
LOWER THAN PAST LABOR/OUTPUT RELATIONSHIPS WOULD INDI-
CATE, LEADING TO SOME TENDENCY TOWARD TIGHTENING IN LABOR
MARKETS. THIS, TOGETHER WITH SPECIAL FACTORS INFLUENC-
ING PRICES IN EARLY 1978, ESPECIALLY FOOD PRICES AND
SOME "CATCH-UP" OF NON-UNION WAGES, HAS LED USG TO MORE
CAUTIOUS APPROACH TO FISCAL POLICY, AS REPRESENTED BY
RECENT CUTBACK IN TAX REDUCTION (\$10 BILLION REDUCTION
IN PROPOSED CUT FOR FY79). THIS STANCE OF FISCAL POLICY
IS CONSISTENT WITH VOLUNTARY INCOMES "DECELERATION"
POLICY -- INCLUDING LIMITED FEDERAL PAY RAISES, DECELER-
ATING STANDARD FOR PRICES AND WAGES -- COORDINATED BY
AMBASSADOR STRAUSS. SCHULTZE OPINED THAT RECENT LOW
PRODUCTIVITY RATE, IMPLIED BY UNEXPECTEDLY STRONG EMPLOY-
MENT GROWTH, WOULD BE PARTIALLY MADE UP (1/3 TO 1/2) IN
NEXT TWO/THREE YEARS AS PRODUCTIVITY MOVES BACK TOWARD

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LONG-TERM TREND RATE; HE SPECIFICALLY DISCOUNTED THEORY THAT DEVIATION FROM TREND EXPLAINABLE BY STATISTICAL ABERRATIONS. RESPONDING TO QUESTIONS ON CURRENT CAPACITY UTILIZATION RATES AS COMPARED TO RATES DURING PERIOD OF HIGH INFLATION IN 1960'S, SCHULTZE NOTED THAT PRESSURE IN 60'S WAS FROM LABOR SUPPLY SIDE, AND DURING 1973 INFLATION SURGE WAS FROM OVERHEATING ON MATERIALS PROCESSING SIDE, WITH LOW UTILIZATION IN OTHER INDUSTRY MASKING THIS PRESSURE IN OVERALL FEDERAL RESERVE CAPACITY UTILIZATION INDEX. GOVERNOR WALLICH (FRB) NOTED THAT INTEREST RATE RISE IN APRIL WAS CONCURRENT WITH BULGE IN GROWTH OF MONETARY AGGREGATES AND THEREFORE DID NOT INDICATE A TIGHTENING OF MONETARY POLICY AS SECRETARIAT HAD IMPLIED IN ITS DOCUMENTATION. SECRETARIAT EXPRESSED CONCERN THAT IF USG GROWTH PROJECTIONS WERE REALIZED, CURRENT ACCOUNT DEFICIT WOULD BE LARGER THAN ITS OWN AND U.S. FORECAST (\$22 TO \$25 BILLION FOR '78); WIDMAN (DAS, TREASURY) CITED HIGH DEGREE OF UNCERTAINTY AT PRESENT TIME IN TRYING TO FORECAST PAYMENTS POSITION A YEAR HENCE, THUS COULD NOT COMMENT ON SPECIFICS OF SECRETARIAT PROJECTIONS.

13. FRANCE: FRENCH DEL (CORTESSE, ECONOMY) WAS SKEPTICAL ON CONCERTED ACTION PROGRAM AS HE SAW MUCH AGREEMENT ON CONCEPT, NONE ON APPLICATION. FRANCE, FOR EXAMPLE, FELT T HAD LITTLE OR NO ROOM FOR MANEUVER UNTIL SOMETIME -- PERHAPS SIX MONTHS -- AFTER OTHERS HAD TAKEN ACTION WHICH WOULD EASE FRANCE'S EXTERNAL CONSTRAINT. HE SUGGESTED OUTLOOK WAS BETTER FOR FRANCE THAN SECRETARIAT PROJECTED IF INFLATION COULD CONTINUE TO BE BROUGHT DOWN WHICH WOULD LEAD TO SPONTANEOUS GROWTH IN PRIVATE SECTOR BY MID-1979. HE STRESSED NEED FOR POLICIES IN FRANCE WHICH RE-ESTABLISH BASIS FOR SUSTAINED

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GROWTH WITHOUT KILLING GROWTH IN SHORT TERM.

14. UK: UK DEL (WASS, TREASURY) COMMENTED PRINCIPALLY ON GENERAL THEMES OF CONCERTED ACTION (NOTED PREVIOUSLY) AND HAD LITTLE TO SAY ON UK SITUATION. HE REVIEWED (WITHOUT DIRECT REFERENCE) CALLAGHAN'S FIVE-POINT PROGRAM FOR THE SUMMIT WITH PARTICULAR EMPHASIS ON (A) THREAT

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ACTION EUR-12

INFO OCT-01 ISO-00 AGRE-00 CEA-01 CIAE-00 COME-00
DODE-00 EB-08 FRB-03 H-01 INR-10 INT-05 L-03
LAB-04 NSAE-00 PA-01 CTME-00 AID-05 SS-15 STR-07
ITC-01 TRSE-00 SP-02 SOE-02 OMB-01 DOE-15 XMB-02
OPIC-03 SIL-01 OIC-02 DOEE-00 EA-10 IO-13 SSO-00
ICAE-00 INRE-00 /128 W
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FM AMEMBASSY PARIS
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POSED BY SLOW GROWTH TO MULTILATERAL FREE-TRADING SYSTEM
AND (B) NOW "LATENT BUT NEVERTHELESS REAL," PROBLEM OF
CURRENCY INSTABILITY, WHICH COULD PARTIALLY BE SOLVED
BY CONCERTED ACTION GROWTH PROGRAM, BUT WOULD ALSO
REQUIRE CLOSE COORDINATION AMONG MONETARY AUTHORITIES
TO SUPPRESS DESTABILIZING MOVEMENTS IN EXCHANGE MARKETS.
IN THIS CONNECTION, HE NOTED "BENIGN NEGLECT NOT ALWAYS
BENIGN." ON PREMISE LARGE CURRENT ACCOUNT IMBALANCES
WILL PERSIST FOR SOME TIME, WASS STRESSED NEED FOR MORE
ADEQUATE CAPITAL FLOWS PARTICULARLY FROM HIGH SURPLUS
COUNTRIES.

15. ITALY: ITALIAN DEL (IZZO, MINISTRY OF BUDGET) SAID
ITALY ALREADY DOING SOMETHING TO PROMOTE GROWTH SINCE
PRESENT UNEMPLOYMENT RATE EXCESSIVE, BOP SITUATION
IMPROVED AND INFLATION RATE COMING DOWN, ALTHOUGH STILL
TOO HIGH. IN ANY CASE, INFLATION COST-PUSH AND WILL NOT
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BE DAMAGED BY STRONGER DEMAND. ITALIAN DEL AMONG THOSE MOST STRONGLY CITING DANGERS OF SLOW GROWTH AND RESULTING PROTECTIONIST MEASURES TO FREE TRADE SYSTEM.

16. CANADA: CANADIAN DEL (HOOD) DID NOT INTERVENE UNTIL DISCUSSION OF WP-2 REPORT. HE WARNED AGAINST COUNTRIES GETTING IMPATIENT WITH FIGHTING INFLATION AND WANTING TO GET ON WITH GROWTH DESPITE THE INFLATION COST. ALTHOUGH NERVOUS ABOUT OVERPLAYING GROWTH, HOOD AGREED WITH GENERAL THRUST OF SECRETARIAT DOCUMENTATION, NAMELY THAT ROOM EXISTS FOR MODERATE, MARGINAL STIMULUS IN SEVERAL COUNTRIES.
SALZMAN

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 jan 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: REPORTS, POLICIES, ECONOMIC REPORTS, COMMITTEE MEETINGS, MEETINGS
Control Number: n/a
Copy: SINGLE
Draft Date: 05 jun 1978
Decaption Date: 01 jan 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 20 Mar 2014
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1978PARIS17725
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Expiration:
Film Number: D780234-0658
Format: TEL
From: PARIS USOECD
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1978/newtext/t19780696/aaaademt.tel
Line Count: 778
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: 07843d92-c288-dd11-92da-001cc4696bcc
Office: ACTION EUR
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 15
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: 78 STATE 131364
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 18 may 2005
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 2489828
Secure: OPEN
Status: NATIVE
Subject: ECONOMIC POLICY COMMITTEE: SUMMARY REPORT ON MAY 29-30 MEETING OF COMMITTEE AND EXPANDED BUREAU
TAGS: ECON, OECD
To: STATE
Type: TE
vdkgvwkey: odbc://SAS/SAS.dbo.SAS_Docs/07843d92-c288-dd11-92da-001cc4696bcc
Review Markings:
Sheryl P. Walter
Declassified/Released
US Department of State
EO Systematic Review
20 Mar 2014
Markings: Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014